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NOTE AND COMMENT.

UNLIQUIDATED TORT CLAIMS AS PROVABLE DEBTS IN BANKRUPTCY.—Considerable litigation has arisen in determining the limitations to be placed upon debts provable in bankruptcy as outlined and enumerated in the Bankruptcy Act of 1898, § 63 a. The reason for much of this litigation being that the provability of debts is employed as a test to determine what are preferences, and what debts are dischargeable. Not a few of the cases thus arising have been with relation to clause four of the above section which provides that debts may be proved and allowed against the bankrupt's estate which are founded upon a contract express or implied. Well illustrating the limitations to be placed upon the provability of claims founded upon implied contract are the two recent cases of *In re Southern Steel Co.* (1910), — D. C. N. D. Ala. —, 183 Fed. 498 and *Clarke* v. *Rogers* (1910), — C. C. A. 1st Cir. —, 183 Fed. 518.

In the former case the Southern Steel Company had incurred a liability for a statutory penalty imposed by the State of Alabama for cutting trees. After the company had been adjudicated a bankrupt a motion was made to liquidate the claim for the statutory penalty in accordance with the provis-

ions of § 63 b of the Bankruptcy Act. The court said that the provability of the claim depended upon whether it came within the scope of § 63 a (4) and held that it did not.

In the latter case one Shaw was testamentary trustee of a number of testamentary trusts among which was one provided for in the will of one Samuel Parsons. Shaw gave the usual probate bond with sureties. He later became insolvent and while in that condition was found by the surety on the bond not to be in possession of some of the securities belonging to the Parsons estate. There was also a shortage in all of the other trust estates held by Shaw. In order to make good the shortage in the Parsons estate, which he was asked to do by the surety, he out of his own funds, and while insolvent purchased bonds to replace those embezzled. Shaw was adjudicated a bankrupt and his trustee in bankruptcy seeks to recover from his successor under the testamentary trust in the Parsons will, the amount of the bonds purchased to replace the shortage in the Parsons estate, alleging that such constituted a preference of creditors and was therefore recoverable under § 60 b of the Bankruptcy Act. It was held that such did amount to a preference and was consequently recoverable by the trustee in bankruptcy. The court in reaching this conclusion found it necessary to determine that the conversion of the bonds was such a tort as might give the injured party a right to waive the tort and sue on implied contract, thus making him a creditor.

The general rule under our present Bankruptcy Act is, that tort claims, unliquidated, and not yet reduced to judgment, are not provable except in cases where the tort may be waived and suit had in implied contract. *Crawford* v. *Burke,* 195 U. S. 176, 12 Am. B. R. 659; *Beers* v. *Hanlin,* 99 Fed. 659, 3 Am. B. R. 745; *In re Hirschman,* 104 Fed. 69, 4 Am. B. R. 715; *Matter of John Wigmore & Sons,* 10 Am. B. R. 661; *In re United Button Co.,* 140 Fed. 495, 15 Am. B. R. 390, aff'd., 149 Fed. 48, 17 Am. B. R. 566. The usual test employed in determining when a tort claim may be waived and suit had in implied contract is that set forth in the principal case of *In re Southern Steel Co.,* viz., is the tort one which has resulted in the unjust enrichment of the wrongdoer as such. The measure of enrichment being the measure of implied contract—citing REMINGTON, BANKRUPTCY, p. 377. This test is a generally accepted principle of the law of quasi contract. *Webster* v. *Drinkwater,* 5 Greenl. 319, 17 Am. Dec. 238; *Berkshire Glass Co.* v. *Wolcott,* 2 Allen (Mass.) 227, 79 Am. Dec. 781; 15 AM. & ENG. ENCYC. LAW, 1111.

This general rule allowing tort claims when as such they may be waived and suit be had in contract is one not peculiar to our present bankruptcy law. It has long been recognized in England and also under our former American Statutes. In England we find the rule adopted at least as early as 1779 when it was involved in the case of *Johnson* v. *Spiller,* Doug. 167, and again in the later cases of *De Tastet* v. *Walker,* Buck, 153 and *Parker* v. *Norton,* 6 Term Rep. 695. It is still maintained in England under the bankruptcy statutes now in force there, which in substance provide that where from the nature of the case a claim may be made in tort or contract, the tort may be waived and proof made on the contract, provable claims embracing

only that class of torts. Stat. 46 & 47 Vict. c. 52, § 37 (8). See also *Re Hopkins*, 86 L. T. Rep. 676.

In this country the earliest recognition of the rule occurred under the Act of 1800, a statute closely following the English Laws upon the subject of Bankruptcy. Under that act the case of *Dusar* v. *Murgatroyd*, Fed. Cas. 4199 was decided, holding that an action arising ex delicto for damages, to be provable before a commission in bankruptcy must be one from which the law will imply a promise to pay. Under the Statute of 1841 it was recognized in the case of *Spalding* v. *State of N. Y.*, 4 How. 21, where an attempt was made to show that a fine imposed by a court for the violation of an injunction was a provable claim and therefore one of which the bankrupt was discharged. The Act of 1867 was more definite upon this point than its predecessors; it provided that, "all demands against the bankrupt for and on account of any goods or chattels wrongfully taken, converted or withheld, may be proved and allowed as debts to the amount of the value of the property so taken and withheld." Act of Mar. 2, 1867 (14 Stat. 517), § 19.

The particular holding in the principal case of *In re Southern Steel Co.* to the effect that a penal liability is not a provable claim arising upon an implied contract, appears to be well supported by the decisions arising under both the Act of 1867 and that of 1898.

Under the former act it was held in the case of *In re Sutherland*, Fed. Cas. 13,639, that the liability for a fine imposed for the commission of a crime was not provable. In *James, Adm'x.* v. *Atlantic Delaine Co.*, 11 N. B. R. 390 a statutory liability of a corporate shareholder under a Rhode Island statute, which was held to be in the nature of a penalty, was not provable. *Garret* v. *Sayles*, 1 Fed. 371 (R. I.) was a similar case arising under the same statute and the same decision was reached. In *Wilson* v. *National Bank*, 3 Fed. 391, the liability for a statutory penalty for usury was held not provable.

Under the present Act of 1898, it was held in the case of *In re Alderson*, 98 Fed. 588, 3 Am. B. R. 544, that a judgment rendered against a bankrupt for a fine upon an indictment for unlawful retailing, was a provable debt. This holding was supported upon the ground that it was a debt amounting to a fixed liability evidenced by a judgment as provided in § 63 a (1) of the Act of 1898. The fact of a judgment having been rendered for the amount of the fine would appear to distinguish it from the case of *In re Southern Steel Co.* *In re Alderson* has however been criticized to the effect that if fines are provable and therefore dischargeable, the discharge would become in effect a pardon of the offense committed, a rather remarkable construction of legislative intent. See note, 3 Am. B. R. 544. This criticism is certainly applicable in support of the holding in *In re Southern Steel Co.*, or in any case involving a statutory liability penal in its nature. The doctrine of *In re Alderson* seems to have been doubted in the later case of *In re Moore*, 6 Am. B. R. 590, which also involved a fine imposed in a criminal suit. It was there held that such was not a debt provable in bankruptcy, the court saying that the provisions of the bankruptcy law have reference alone to civil

liabilities, as demands between debtor and creditor as such, and not punishments inflicted pro bono publico for crimes committed. In the case of *In re Rouse,* 1 Am. B. R. 393, a statutory liability of corporate shareholders, was held to be a debt provable in bankruptcy. The statute involved was an Ohio Statute which had been held not to be penal in its nature but partook rather of the nature of a contract and so the case was distinguished from those decided under the law of 1867 and cited supra. In *Patterson* v. *Thompson,* 86 Fed. 85, the court said that statutes making officers and directors of a corporation responsible to its creditors for losses growing out of the negligent, wrongful, or fraudulent conduct of its officers, are considered by most courts as of a penal nature and not arising out of contract. Evidently the Ohio statute is among the minority, but the decision of the bankruptcy court could not well have been otherwise, in view of the practice of these courts to follow the interpretation placed by the state courts upon their own statutes.

The case of *Clark* v. *Rogers,* supra, presents a somewhat simpler situation as to claims provable, which are founded upon implied contract. There the question was, as to whether the conversion of the securities composing part of the trust estate, was such a tort as would give the injured party a claim against the tort-feasor, recoverable in either tort or contract. Applying the test of unjust enrichment, and benefit to the tort-feasor, as above stated, it would seem to readily follow that the injured party had such a claim, and being such, it was provable in bankruptcy against the estate of the tort-feasor. The court held that there was an express contractual obligation upon the probate bond bringing the case within § 63 a (4) of the Act of 1898. Yet aside from this it held that there existed an obligation of a contractual nature resting upon the defaulting trustee to restore the value of the property he had embezzled.

The court having determined that the claim was a provable one, found the injured party to be a creditor. See Act of 1898, ch. I, § 1 a (9). A conveyance therefore by one who is insolvent, of part of his assets to a creditor, operating as a preference, brings the case within the provisions of § 60 b of the Bankruptcy Act and this was the ultimate proposition to be determined. The case of a return of a part of the funds of a trust estate by a trustee who had embezzled the funds of a number of trusts held by him, the return being made while the trustee was insolvent, is a unique instance of a preference of creditors.

These cases appear to be fair illustrations of situations constantly bound to arise, which though not apt to cause any contrariety of opinion upon the fundamental principles involved, are yet certain to be puzzling enough to test to their utmost the rather mechanical rules applied. J. C. M.

MAY A STATE, IN THE EXERCISE OF ITS POLICE POWER, REGULATE INSURANCE RATES?—The first case ever decided in this country involving the validity of state legislation regulating the rates of insurance was recently rendered by the United States Circuit Court. *American Surety Company of New York* v. *Shallenberger, et al.* (1911), — C. C. D., Neb., L. D. —, 183 Fed. 636.